



November 19, 2004

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington D.C. 20551

Attention: Docket No. R-1210

Re: Electronic Fund Transfers
69 FR 55996 (September 17, 2004)

Dear Ms. Johnson:

America's Community Bankers (ACB)¹ is pleased to comment on the proposal issued by the Board of Governors of the Federal Reserve System (Federal Reserve) that would amend Regulation E, which implements the Electronic Fund Transfer Act (EFTA).² The proposal would also revise portions of the official staff commentary to the regulation.

The proposed regulatory amendments would establish notice and authorization requirements for merchants and other payees that engage in electronic check conversion. In addition, certain payroll card accounts would become subject to Regulation E.

The proposed commentary revisions would provide guidance on preauthorized transfers, additional electronic check conversion issues, error resolution, and disclosure matters.

ACB Position

ACB generally supports the proposed changes to Regulation E and its commentary. We request the Federal Reserve to review Regulation E on an ongoing basis to keep pace with the evolution of the payments system.

¹ America's Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit www.AmericasCommunityBankers.com.

² 69 Fed. Reg. 55996 (September 17, 2004).

- In most instances, ACB supports requiring merchants and payees to inform consumers that the merchant or payee intends to convert the consumer's check to an electronic funds transfer from the consumer's deposit account. However, there are occasions when we do not believe that it is appropriate to require this notice to be provided for each transaction.
- ACB opposes requiring payees to obtain a separate signed, written authorization to initiate a one-time electronic funds transfer (EFT) using information from the consumer's check.
- ACB generally supports extending Regulation E to payroll cards that are used to compensate employees on a recurring basis.
- ACB supports clarifying that if a consumer fails to notify the institution of an error in a timely manner, the institution is not required to comply with Regulation E's investigation requirements and time limits.
- ACB urges the Federal Reserve to align Regulation E's 60 day time frame for error resolution with that of the NACHA rules.
- ACB questions the likelihood that a receiving depository financial institution (RDFI) would have readily available information that justifies expanding the "four walls rule."
- ACB supports the withdrawal of the interpretation that a recording of a telephone conversation with a consumer who agrees to recurring debits does not constitute written authorization. We also urge the Federal Reserve to specify whether a recorded conversation is consistent with the E-Sign Act and is Regulation E compliant.
- ACB urges the Federal Reserve to acknowledge that a stop payment order stops a single electronic funds transfer and is not sufficient to stop a recurring debit.
- ACB generally supports requiring financial institutions to list electronic check conversion as one of the types of transfers that a consumer can make. However, we request that institutions be given one year to comply with any revised notice requirements.

Electronic Check Conversion

The proposed amendments to Regulation E would require merchants and other payees to obtain a consumer's authorization to use information contained on a consumer's paper check to initiate a one-time electronic fund transfer from a consumer's account. This

process is known as electronic check conversion (ECK).³ The proposal would also require payees that initiate an electronic transfer to notify the consumer that when a check is used to initiate an electronic fund transfer, funds may be debited from the consumer's account quickly, and that the consumer's check will not be returned by the financial institution holding the consumer's account. The Federal Reserve has proposed model language to help merchants and payees comply with this requirement. Depository institutions that initiate an electronic funds transfer using information from a consumer's check would be subject to the proposed requirements.

Notice Requirement. ACB believes that consumers should be informed when a merchant or other payee intends to convert the consumer's check to an electronic funds transfer from the consumer's deposit account. Electronic check conversion has implications for how consumers elect to manage their personal funds. EFTs often clear more quickly than paper checks, thus reducing perceived "float" time. In addition, if a check is converted into an electronic check transaction, a consumer will not receive a cancelled check or an electronic image of a cancelled check with his or her periodic deposit account statement.

Recent technological and legal changes to the payments system have been confusing to the general public. We are concerned that consumers have difficulty distinguishing between check conversion at the point of sale, accounts receivable entries (ARC transactions), and check truncation. In many instances, consumers look to their financial institutions to explain these changes regarding how their checks are processed. Often it is difficult to help consumers understand that a cancelled check or an electronic image of a cancelled check will not be included with their periodic account statement because the payee, not the depository institution, processed the check as an electronic funds transfer. Accordingly, we believe that it is appropriate to require merchants and other payees to notify consumers that by providing a check, the consumer authorizes the payee to make a one-time electronic funds transfer from the consumer's account.

Merchants and payees are in the best position to notify consumers about electronic check conversion. First, merchants and payees make the decision to engage in electronic check conversion. Second, disclosure prior to a transaction will improve consumer awareness of the check processing options that are available to payees. We also believe it is important for consumers to understand that checks are clearing much more quickly and that they should not write checks unless there are sufficient funds in the account. In all cases, the notice should be brief, conspicuous, and easy to understand.

³ In electronic check conversion, the payee electronically scans and captures the MICR-encoding on the check for the routing, account, and serial numbers, and enters the amount to be debited from the consumer's asset account. If electronic check conversion occurs at a point of sale (POS) terminal, the paper check is scanned and handed back to the consumer. Check conversion may also occur when a consumer mails a check to a payee who converts the check to an electronic transaction item. This form of check conversion is referred to as an accounts receivable conversion, or ARC transaction. Consumers do not receive a cancelled check or an electronic representation of a cancelled check for ARC transactions.

While we generally support disclosure and improved consumer awareness, we question whether disclosures will be meaningful to consumers in certain circumstances. The preamble to the proposed amendments states that “generally, a notice about authorizing an ECK transaction would have to be provided for each transaction.”⁴ This would mean that language regarding authorization of an ECK transaction would be required on every billing statement, such as a monthly credit card bill. We would note that credit card statements are already full of information regarding the account relationship, including information pertaining to the annual percentage rate (APR) and the annual percentage yield (APY), procedures for disputing a claim, and procedures for reporting lost or stolen credit cards. Requiring institutions that engage in check conversion to print additional information on every billing statement may not have the effect of increasing consumer awareness on a broad scale. Rather, there is a substantial risk that consumers would simply pass over the additional information. In addition, the large amounts of information already contained on monthly billing statements would make it difficult for any required notice to meet the clear and conspicuous standard set forth in the proposal.

We also request the Federal Reserve to recognize that there will be circumstances when it will not be reasonable or practicable to provide a notice for every transaction. For example, many community banks provide customers with coupon books to use when making payments on mortgage, automobile, personal, or other loans. Each page of the coupon lists the payment amount and the date the payment is due. Consumers tear out the appropriate coupon and include it with the check that is used to make each payment. Coupon books are approximately the size of a personal checkbook and typically include coupons for one year’s worth of payments.

Given the size constraints and the manner in which coupon books are issued, it would not be practical to print the proposed check conversion notice on each coupon. First, there would not be sufficient space to print the proposed disclosure on the front of each coupon. It would be possible to print the notice on the back of each coupon, but it is unclear whether this would meet the requirement that the notice be clear and conspicuous. Moreover, if a notice requirement were adopted, financial institutions would incur substantial costs to reprint existing coupon books and mail them to consumers.

The examples above should not be construed as a lack of support for improving consumer awareness regarding changes in check processing. Rather, they are intended to illustrate that improving consumer awareness cannot be achieved simply by requiring disclosure language to be printed on a monthly billing statement. This is particularly true given the new environment created by the implementation of the Check Clearing for the 21st Century Act⁵ (Check 21) and the misinformation that exists in the media and among some consumer advocacy groups regarding check processing. Accordingly, we urge the Federal Reserve to consider carefully which disclosure methods for ARC transactions

⁴ 69 Fed. Reg. 55997.

⁵ 12 U.S.C. 5001 *et. seq.*

would provide a genuine benefit to consumers without unnecessarily interfering with existing practices of financial institutions.

There is no consensus among community banks as to the best approach for informing consumers about electronic check conversion. ACB has received the following suggestions:

- Notify the consumer annually.
- Notify the consumer on each billing statement.
- Permit a one-time notice as long as the notice is located in a prominent location and is readily understandable.
- Allow the proposed notification requirement to expire after a set period of time.

Any notice requirement would require costly changes to procedures and computer systems. We request the Federal Reserve to work with financial institutions, other payees, the banking trade associations, and consumers to test disclosure methods to determine the appropriate balance for achieving consumer awareness without unduly burdening payees that engage in electronic check conversion. We also encourage the Federal Reserve to discuss the results of any such testing with its Consumer Advisory Council.

We would emphasize that electronic check conversion is one step in the evolution of the payments system. We urge the Federal Reserve to re-evaluate any notice requirement that is adopted as a result of this rulemaking to ensure that financial institutions and other payees are not unnecessarily burdened by a regulatory requirement that is no longer relevant or materially beneficial to consumers.

Authorization Requirement. ACB opposes requiring payees to obtain a separate signed, written authorization to initiate a one-time EFT using information from the consumer's check. We believe that authorization should be implied if the consumer is notified about the payee's intent to convert the check to an EFT and elects to go forward with the transaction using a check.

ACB strongly supports empowering payees to use efficient means to collect on checks. Requiring payees to collect and retain written authorization for every check that is converted to an electronic funds transfer would negatively impact the business case for this model of check collection.

Payroll Cards

ACB generally supports the Federal Reserve's proposal to extend Regulation E to payroll cards. As a general matter, we believe that Regulation E should apply only to those payroll cards that mimic traditional deposit accounts.

Under the proposal, a payroll card account established by an employer on behalf of a consumer to which EFTs of the consumer's wages, salary or other employee compensation are made on a recurring basis would be an "account" covered by Regulation E. Regulation E would apply regardless of whether the funds are held in individual employee accounts or in a pooled account, with "subaccounts" maintained by a depository institution (or by a third party) that enable a determination of the amounts of money owed to particular employees. Regulation E would not apply to 1) other types of stored value cards (e.g. gift cards) or 2) a card used for a one-time EFT of a salary-related payment, such as a bonus, or a card used solely to disburse non-salary-related payments, such as petty cash or a travel per diem card.

Certain variations of stored value products are designed to be treated like cash, while others have deposit account characteristics. For example, issuing banks maintain account ledgers that relate to the institution's deposit taking function as well as records of the funds that belong to each cardholder. Some payroll cards may be reloadable, the cardholder's name may be printed on the face of the card, the card may have a PIN or signature based security feature, the cardholder may be able to make additional deposits to the card, use the card at an ATM, or use the card to pay for goods at merchants that accept traditional credit and debit cards. Occasionally, a financial institution will brand the payroll cards that it issues.

We believe that it is good public policy to provide Regulation E coverage to those payroll cards that mimic traditional deposit accounts. These types of arrangements clearly attribute funds to a particular cardholder. Specifically, we believe that payroll cards should be subject to Regulation E only when a clear and unmistakable account can be identified with a particular consumer. We believe that this logic should be applied to all regulatory aspects of stored value products, including Regulation CC, which implements the Expedited Funds Availability Act, the USA Patriot Act and its implementing regulations, and the FDIC's deposit insurance regulations.

Other forms of payroll cards are designed only to provide an alternative to a paycheck. They are not designed to function like a traditional deposit account that accepts multiple credits and debits and identifies a specific individual with a specific account number and account balance. Accordingly, Regulation E should not apply to these arrangements.

While we support the public policy behind the proposed amendment, we are concerned about the practical implications of extending Regulation E to payroll cards. For example, some payroll card recipients are migrant workers. These individuals may only live in a given location a few months each year. If payroll cards were subject to Regulation E, financial institutions would be required to distribute periodic statements to each payroll card recipient. It is likely that many account statements would be returned to the issuing institution because the worker has moved on to another geographic location. We believe that these individuals would be less likely to leave a forwarding address than traditional bank customers.

Many community banks have been reluctant to enter the stored value market. Regulatory uncertainties persist regarding the application of Regulation E, Regulation CC, and the USA Patriot Act. Moreover, community banks must partner with third party vendors to make stored value products economically feasible. As community banks monitor the stored value market, we expect additional product development as the regulatory treatment of this product is addressed. We urge the Federal Reserve to give financial institutions the flexibility necessary to develop new payroll card products that suit the needs of their customers.

Even though community banks are just beginning to explore the payroll card market, we are concerned that imposing differential regulation on depository institutions and less regulated providers of stored value products may discourage innovation and could conceivably eliminate insured institutions as major participants in the development of payroll card products. We urge the Federal Reserve to ensure that all providers of payroll card services are treated equally under any amendment to Regulation E.

Error Resolution

Notice of Error from Consumer. Regulation E establishes procedures for resolving errors associated with electronic funds transfers, including the time limits within which a financial institution must conclude an investigation, provisionally credit a consumer's account, where applicable, and notify the consumer of the results of the investigation. The time limits and procedures required are triggered when a consumer notifies the financial institution of an error "no later than 60 days after which the institution sends the periodic statement or provides the passbook documentation...on which the alleged error is first reflected."

The proposed revision to the Regulation E commentary would clarify that if a consumer fails to notify the institution of an error in a timely manner, the institution is not required to comply with Regulation E's investigation requirements and time limits. Where the error involves an unauthorized EFT, however, liability for the unauthorized transfer could not be imposed on the consumer unless the institution satisfies Regulation E's disclosure requirements.

ACB supports this clarification. The burden should not be on a financial institution to comply with the established time limits and error resolution procedures if a consumer does not notify the financial institution of the error in a timely fashion.

Although not addressed in the current proposed revisions, ACB requests the Federal Reserve to consider additional modifications to Regulation E's error resolution procedures. Currently, Regulation E allows consumers to dispute an electronic charge to their account within 60 days after the institution sends the periodic statement to the consumer. The existing NACHA rules, which govern the relationship between the originating institution and the receiving institution for purposes of processing ACH entries, require RDFIs to return disputed debit entries no later than the opening of

business on the banking day following the 60th calendar day following the settlement date of the entry. While both Regulation E and the NACHA rules use a 60 day timeframe, the 60 day periods begin to run at different times.

ACB encourages the Federal Reserve to make the 60 day time frame consistent with the NACHA rules. Specifically, we request the Federal Reserve to adopt a 60 day timeframe that begins on the calendar day following the settlement date of the entry. Consistency between NACHA rules and Regulation E in this area will provide clearer guidelines for financial institutions faced with disputes regarding to electronic items.

Time Limits and Extent of Investigation. Currently, Regulation E permits an institution to limit the investigation of an alleged error to “a review of its own records” where the alleged error pertains to a transfer to or from a third party with whom the institution has no agreement for the type of EFT involved. This is commonly known as the “four walls rule.” The proposal would clarify that a financial institution would satisfy its error resolution obligations by reviewing all information within the institution’s own records that would assist in resolving an alleged error. An institution’s “own records” would include any information available within the institution that could be used to determine whether an error has occurred. Merely reviewing payment instructions for ACH, electronic check conversions, and other transactions would not be sufficient.

ACB questions whether an RDFI would have readily available and concrete information in its records that would assist in the review of the transaction at issue. The consumer’s authorization for the transaction would be in the possession of the originator-payee, not the RDFI.

Preauthorized Transfers

Written Authorization. Regulation E requires preauthorized transfers to be authorized by a writing that is signed or similarly authenticated by a consumer. Due to the passage of the E-Sign Act, the Federal Reserve proposes to withdraw its earlier interpretation that a recording of a telephone conversation with a consumer who agrees to recurring debits does not constitute written authorization.⁶ The withdrawal of this clarification is not a per se interpretation of the E-Sign Act. However, the preamble to the proposed amendment states that if a tape recorded authorization was determined by the person obtaining the authorization to constitute a written and signed (or similarly authenticated) authorization, then the authorization would satisfy the Regulation E requirements.⁷

ACB supports removing this inconsistency between the commentary to Regulation E and the E-Sign Act. The proposed amendment would be one step toward enabling financial institutions to more fully use the provisions of the E-Sign Act to make their operations more efficient. However, instead of merely withdrawing the existing clarification, we

⁶ 15 U.S.C. 7001 *et. seq.* In general, the E-Sign Act provides that electronic records and electronic signatures satisfy any legal requirements for traditional written records and signatures.

⁷ 69 *Fed. Reg.* 56003.

request the Federal Reserve to clarify that a recorded conversation is consistent with the E-Sign Act and is sufficient to comply with Regulation E's written authorization requirement.

Consumer's Right to Stop Payment. The proposal would clarify that an institution that does not have the capability to block a preauthorized debit from being posted to the consumer's account (e.g. a preauthorized debit made through a debit card network or other real-time system) may instead use a third party to block the transfer(s) as long as the recurring debits are in fact stopped.

While this clarification is somewhat helpful, we urge the Federal Reserve to acknowledge in the Regulation E commentary that a stop payment order stops a single electronic funds transfer and is not sufficient to stop a recurring preauthorized debit. Community banks report that blocking preauthorized debits can be especially challenging. This is due, in part, because consumers order financial institutions to stop payment on a transaction without revoking the originator's authorization to debit the consumer's account on a recurring basis. Simply instructing an institution to stop payment is not sufficient; consumers must revoke authorization through the originator. A related problem occurs when consumers do not provide their financial institution with written confirmation that the consumer has informed the payee-originator of the revocation. In addition, it is common for consumers to revoke authorization from merchants and other service providers, yet merchants keep sending debits to the consumer's account.

Disclosures

Initial Disclosures. The proposal would require financial institutions to list electronic check conversion transactions among the types of transfers that a consumer can make. As a result, institutions would be required to provide new disclosures to consumers as applicable.

The proposal would add to the compliance costs of community banks. New disclosures would have to be printed and mailed to customers. Nevertheless, ACB generally supports the disclosure requirement, so long as financial institutions have sufficient time to implement this change. Many institutions have already established compliance budgets and ordered Regulation E disclosures for the coming year. Accordingly, we request that institutions be given one year to comply with the revised notice requirements.

ACB is concerned about the litigation risk that recent changes in check processing pose to community banks. As a result, we request the Federal Reserve to specify that institutions will not be subject to liability until the compliance date for any disclosures required in conjunction with this rulemaking.

Disclosures at ATM Machines. The proposal would provide that an ATM operator that imposes a fee for a specific type of transaction (such as a cash withdrawal) but not for another (such as a balance inquiry), or imposes a fee only on some customers, may

provide a general notice that a fee may be imposed. ATM operators that charge a fee in all instances would still be required to disclose that a fee will be charged for the transaction.

ACB supports enabling institutions to be more precise in fulfilling their disclosure obligations.

Conclusion

ACB appreciates the opportunity to comment on this important matter. We look forward to working with the Federal Reserve to help develop the regulations necessary to address ongoing changes to the payments system. We reiterate our position that:

- In most instances, merchants and payees should be required to inform consumers that the merchant or payee intends to convert the consumer's check to an electronic funds transfer from the consumer's deposit account. However, there are instances where we do not believe that it is appropriate to require this notice to be provided for each transaction.
- Payees should not be required to obtain a separate signed, written authorization to initiate a one-time EFT using information from the consumer's check.
- As a general matter, Regulation E should be extended to payroll cards that are used to compensate employees on a recurring basis.
- The Federal Reserve should clarify that if a consumer fails to notify the institution of an error in a timely manner, the institution is not required to comply with Regulation E's investigation requirements and time limits.
- The Federal Reserve should align Regulation E's sixty-day time frame for error resolution with that of the NACHA rules.
- It is unlikely that an RDFI would have readily available information that justifies expanding the "four walls rule."
- The Federal Reserve should withdraw its interpretation that a recording of a telephone conversation with a consumer who agrees to recurring debits does not constitute written authorization. We also urge the Federal Reserve to specify whether a recorded conversation is consistent with the E-Sign Act and is Regulation E compliant.
- The Federal Reserve should acknowledge that stop payment orders stop a single electronic funds transfer and is not sufficient to stop a recurring debit.

Electronic Fund Transfers


November 19, 2004

Page 11

- Financial institutions should list electronic check conversion as one of the types of transfers that a consumer can make. However, we request that institutions be given one year to comply with any revised notice requirements.

Please contact the undersigned at 202-857-3121 or Krista Shonk at 202-857-3187 should you have any questions.

Sincerely,

A handwritten signature in cursive script that reads "Charlotte M. Bahin".

Charlotte M. Bahin
Senior Vice President
Regulatory Affairs